WEXPRO COMPANY

174 IBLA 57 Decided March 11, 2008

United States Department of the Interior
Office of Hearings and Appeals
Interior Board of Land Appeals
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Arlington, VA 22203

WEXPRO COMPANY

IBLA 2007-203 Decided March 11, 2008

Appeal from a decision of the Deputy State Director, Utah State Office, Bureau of Land Management, affirming a decision of the Assistant Field Office Manager, Vernal, Utah, Field Office, denying beneficial use of gas produced from the Island Unit. SDR UT 07-02.

Reversed and remanded.

1. Oil and Gas Leases: Royalties: Generally--Oil and Gas Leases: Unitization

Gas used as fuel in compression, dehydration, and other operations within a unitized area may qualify as gas used for beneficial purposes and therefore may be free of royalty obligations even if the use occurs after a wellhead point of measurement for royalty purposes.

APPEARANCES: John F. Shepherd, Esq., Denver, Colorado, for Wexpro Company; Christopher J. Morley, Office of the Regional Solicitor, Salt Lake City, Utah, for the Bureau of Land Management.

OPINION BY ADMINISTRATIVE JUDGE HEATH

Wexpro Company (Wexpro) has appealed an April 4, 2007, decision of the Deputy State Director, Lands and Minerals, Utah State Office, Bureau of Land Management (BLM) (SD Decision), that affirmed the January 22, 2007, decision of the Assistant Field Office Manager, Vernal, Utah, Field Office (VFO Decision), denying royalty-free beneficial use status to gas produced from the Island Unit in Utah that was used to power compressors, a dehydrator, and a so-called "Joule-Thomson" or "JT" facility (sometimes called a "JT skid") on the unitized area. For the reasons explained below, we reverse the SD Decision and remand the matter to BLM to determine the extent to which gas used as fuel in the compressors, the dehydrator, and the JT facility qualifies for royalty-free treatment.

FACTUAL AND LEGAL BACKGROUND

A. *The Island Unit and Wexpro's Notice Regarding "Beneficial Use" Fuel Gas*

The Island Unit is located in Uintah and Duchesne Counties in northeastern Utah. According to BLM, it includes both Federal and Indian oil and gas leases and has approximately 65 producing wells. Answer at 1-2. The U.S. Geological Survey (USGS) approved the Island Unit Agreement on August 26, 1960. *See* Wexpro's Statement of Reasons (SOR), Exhibit (Ex.) A.[1] Mountain Fuel Supply Company (MFS), now known as Questar Corp., was the original designated unit operator. *Id.* § 4. Through subsequent changes in corporate organization and names, Wexpro (a wholly-owned second-tier subsidiary of Questar) succeeded MFS as unit operator on April 11, 1984. SOR at 2 and Ex. B; Answer at 2. Gas produced from unit wells is measured for royalty reporting and computation purposes by orifice and electronic flow meters. A single meter is installed on each well pad with either one or multiple wells. In both situations, meters are referred to as wellhead meters. SD Decision at unpaginated 1. BLM considers the wellhead meters to be the point of measurement (POM). In this case, no off-lease measurement has been requested or approved under 43 C.F.R. § 3162.7-3. *See* SD Decision at 1-2; SOR at 5; Answer at 2.

For many years, gas produced from the unit was compressed in compressors that were not located within the unit boundaries. However, compressors were installed on the unit in September 2004. Subsequently, in April 2006, the JT skid was installed on the unit.[2] According to Wexpro, as the system is currently designed, after gas is measured at the respective wellhead POMs, it enters a gathering system that accumulates it to a central point on the unit, where it goes through two compressors, a dehydrator, and the JT skid, each of which consumes gas as fuel.[3] The precise function of the JT skid is not explained in the record.[4] At each location

[1] Responsibility for administering onshore Federal oil and gas leases later was delegated to BLM. *See* Secretarial Order 3087 (Dec. 3, 1982, amended Feb. 7, 1983), 48 Fed. Reg. 8983 (Mar. 2, 1983). *See also* 43 C.F.R. § 3160.0-9(d) and 43 C.F.R. Part 3180, preliminary note.

[2] The compressors, the dehydrator, and the JT skid are owned by a Questar subsidiary known as Questar Gas Management (QGM).

[3] *See* SOR at 5; map of Island Unit attached as Ex. D; schematic of unit operation attached as Ex. E (where the compressors, dehydration unit, and JT skid are designated as the "QGM Comp/JT Plant").

[4] We infer from the name given to this facility that it employs the Joule-Thomson Effect in its process. The Joule-Thomson Effect is the change in temperature (in these

(continued...)

where gas is consumed as fuel, it is measured in a fuel gas meter. After the QGM Comp/JT Plant, the gas then goes into the Questar Pipeline Company main transmission line.

On May 22, 2006, Wexpro submitted a sundry notice to the BLM Vernal Field Office (VFO) seeking approval of Wexpro's proposed method to allocate fuel gas between gas produced from Island Unit wells and gas produced by third parties outside the unit that Wexpro planned to condition in the Island Unit facilities. The percentage of fuel gas allocated to the Island Unit wells would be treated as "lease free fuel gas for beneficial use" — *i.e.*, would be royalty-free. SOR at 5 and Ex. F.

B. *The Vernal Field Office Decision and the State Director Decision*

The January 22, 2007, VFO Decision denied Wexpro's "request for beneficial natural gas use[.]" The stated reasons were: "1. Wexpro does not own/lease and operate the natural gas compressor and JT skid. 2. The natural gas compressor and JT skid are past the royalty point of measurement." The effect of that decision was that the fuel gas did not qualify as royalty-free "beneficial use" gas.

On February 20, 2007, Wexpro sought State Director review of the VFO Decision. In a supporting brief dated March 14, 2007, Wexpro argued (1) the fact that a Wexpro affiliate operates the compressor and JT skid is irrelevant because Wexpro provides the fuel that is consumed within the unit; and (2) regardless of the point of royalty measurement, the terms of both the unit agreement and "Notice to Lessees and Operators of Onshore Federal and Indian Oil and Gas Leases (NTL-4A)," 44 Fed. Reg. 76600 (Dec. 27, 1979) (NTL-4A), provide that where gas is used for beneficial use, no royalty is due on it. Wexpro's Brief in Support of Appeal at 1-4. Wexpro also maintained that the determination of whether the gas was royalty-free because it was for beneficial use was a question for BLM, not for the Minerals Management Service (MMS), as explained in the preamble to MMS' 1988 gas valuation rulemaking, 53 Fed. Reg. 1230, 1233 (Jan. 15, 1988).

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[4] (...continued)
facilities, cooling) that occurs when gas is allowed to expand freely at constant enthalpy, *i.e.*, at constant heat content and without external work performed. *See, e.g.*, M.W. Zemansky, *Heat and Thermodynamics* (McGraw-Hill, 1968), at 182, 335; D.V. Schroeder, *Thermal Physics* (Addison Wesley Longman, 2000), at 142. The current record does not contain sufficient information to show whether the JT facility in this case is used to liquefy and separate (1) natural gas liquid hydrocarbons (NGLs) (such as ethane, propane, butane, and heavier hydrocarbons), (2) water vapor, or (3) both, from the natural gas stream.

The April 4, 2007, SD Decision affirmed the VFO, but on different grounds. Relying on WO IM [Washington Office Instruction Memorandum] No. 90-474, dated May 11, 1990 (1990 IM), the Deputy State Director stated that

> once produced gas passes beyond BLM's POM, the gas is no longer under BLM's jurisdiction. Consequently, BLM will not consider whether gas that had passed beyond BLM's POM may be used royalty free. However, production used past BLM's POM, depending on circumstances, might be considered by the Minerals Management Service (MMS) as subject to transportation or other allowances. . . . This position has been upheld in *Lone Mountain Production Co.*, 139 IBLA [244], 248 (1997). WO IM 90-474 has not been superseded and it reflects BLM's current policy on beneficial-use determinations.

SD Decision at unpaginated 1-2. In rejecting Wexpro's argument that BLM had jurisdiction under the unit agreement and NTL-4A to determine whether the fuel gas was for a beneficial use for the unit, the Deputy State Director further reasoned:

> Wexpro asserts that the Island Unit Agreement and Notice to Lessees No. 4-A compels [*sic*] BLM to assume jurisdiction over its request for beneficial use. However, we are unable to find anything in either of those documents governing BLM's jurisdiction here. Wexpro also contends that a 1988 preamble to MMS' gas royalty regulations recognizes BLM's jurisdiction in this case. This argument, however, was rejected in *Lone Mountain Production Co.*, cited above.

Id. at 2. The SD Decision also held that the fact that the compressor and JT skid were owned by a Wexpro affiliate was immaterial. *Id*. Finally, the SD Decision stated that "[n]othing herein should be construed as taking a position as to whether MMS should or should not grant Wexp[r]o's beneficial use request, if such a request is made." *Id*.

Wexpro appealed. Because Wexpro's arguments are based on, and resolution of the issues involved turns on, the unit agreement and applicable regulations and agency notices, we examine those provisions next.

C. *Relevant Regulatory and Unit Agreement Provisions*

1. *The Island Unit Agreement*

Section 12 of the unit agreement, under the heading "Allocation of Production," provides in relevant part:

> All unitized substances produced from each participating area established under this agreement, *except any part thereof used in conformity with good operating practices within the unitized area for drilling, operating, camp and other production or development purposes* . . . or unavoidably lost, shall be deemed to be produced equally on an acreage basis from the several tracts of unitized land of the participating area . . . and . . . each such tract of unitized land shall have allocated to it such percentage of said production as the number of acres of such tract included in said participating area bears to the total acres of unitized land in said participating area . . . .

Island Unit Agreement (SOR Ex. A) at 16 (emphasis added). Section 14 then provides that royalty shall be paid "as to all unitized substances on the basis of the amounts thereof allocated to unitized Federal and Indian land . . . ." *Id*. at 18-19.[5] In short, under the unit agreement, gas used within the unitized area for operating and other production and development purposes is not subject to royalty.

2. *NTL-4A and Related MMS Regulations*

The USGS Conservation Division issued "Notice to Lessees and Operators of Federal Onshore Oil and Gas Leases (NTL-4)" on November 15, 1974. NTL-4 required lessees to pay royalty on all oil and gas produced from a lease or unit, including production used in lease or unit operations or unavoidably lost, reversing the Department's prior longstanding view.[6] The position taken in NTL-4 was rejected in two cases, *Marathon Oil Co. v. Andrus*, 452 F. Supp. 548 (D. Wyo. 1978), and *Gulf Oil Corp. v. Andrus*, 460 F. Supp. 15 (C.D. Cal. 1978). As the district court explained in *Marathon Oil Co. v. Andrus:*

> Prior to the issuance of the NTL-4 Notice, the practice of the United States Department of the Interior had been that, in determining the amount of production to which royalty rates will be applied, no royalty is payable on oil or gas unavoidably lost, *used in lease or producing operations on the leasehold premises, or beneficially used for purposes of production on the leasehold*.

[5] The unit agreement also provided that the "royalty requirements of all Federal leases committed to said agreement are hereby established, altered, changed, or revoked to conform with the terms and conditions of this agreement." SOR Ex. A, cover page.

[6] The position taken in NTL-4 was approved in an opinion of the Solicitor that was approved by the Secretary and issued on Oct. 4, 1976, M-36888, 84 I.D. 54. *See also* M-36888 (Supp. II), Mar. 9, 1977, 84 I.D. 171.

> For more than half a century, both the government, as lessor, and all of its lessees have understood and have been governed by the pertinent statutes to the end that all oil and gas used on the lease for ordinary production purposes or unavoidably lost were not subject to royalty payments to the government. Nor has the Department attempted to collect royalties on the aforesaid oil and gas unavoidably lost or used in venting or flaring in the processing facilities until the issuance of the NTL-4 Notices.

452 F. Supp. at 551 (emphasis added). The court then rejected the NTL-4 interpretation as contrary to the Department's long-standing construction of the Mineral Leasing Act. The court held:

> A review of the legislative history of the Mineral Leasing Act, together with its many enactments and re-enactments, each leaving intact the wording that a royalty is to be paid on "value of the production removed or sold from the lease", plus the interpretation placed thereon by the Secretary of the Interior for a long period of time holding that royalties are not to be collected on oil and gas that was unavoidably lost *or used in lease operations*, are entitled to great weight.

452 F. Supp. at 552-53 (emphasis added). The district court in *Gulf Oil Corp. v. Andrus* reached the same conclusion after examining the legislative history of the quoted phrase in section 17(b) of the Mineral Leasing Act, 30 U.S.C. § 226(b) (2000), imposing royalty as a specified percentage in amount or value of the production "removed or sold from the lease." 460 F. Supp. at 17-18.[7]

Following the *Marathon* and *Gulf* decisions, USGS issued NTL-4A on December 27, 1979, revoking pertinent provisions of NTL-4 retroactively. NTL-4A applies to both Federal and Indian leases. Part I of NTL-4A provides in relevant part:

> Gas Production (both gas well gas and oil well gas) subject to royalty shall include that which is produced and sold on a lease basis or for the benefit of a lease under the terms of an approved communitization or unitization agreement. *No royalty obligation shall accrue on any produced gas which (1) is used on the same lease, same communitized tract, or same unitized participating area for beneficial purposes* . . . .

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[7] Subsequently, two cases involving offshore leases also rejected notices issued to offshore Federal oil and gas lessees that asserted the same position taken in NTL-4. *Placid Oil Co. v. Department of the Interior*, 491 F. Supp. 895 (N.D. Tex. 1980); *Amoco Production Co. v. Andrus*, 527 F. Supp. 790 (E.D. La. 1981).

44 Fed. Reg. 76600 (Dec. 27, 1979) (emphasis added). Part II.B. of NTL-4A then defined "beneficial purposes" as follows:

> "Beneficial purposes" shall mean that oil or gas which is produced from a lease, communitized tract, or unitized participating area and which is used on or for the benefit of that same lease, same communitized tract, or same unitized participating area for *operating or producing purposes such as* (1) fuel in lifting oil or gas, (2) fuel in the heating of oil or gas for the purpose of placing it in a merchantable condition, (3) *fuel in compressing gas for the purpose of placing it in a marketable condition*, or (4) fuel for firing steam generators for the enhanced recovery of oil. Gas used for beneficial purpose shall also include that which is produced from a lease, communitized tract, or unitized participating area and which is consumed on or for the benefit of that same lease, same communitized tract, or same unitized participating area (1) as fuel for drilling rig engines, (2) as the source of actuating automatic valves at the production facilities, or (3) with the prior approval of the Supervisor, as the circulation medium during drilling operations. *Where the produced gas is processed through a gasoline plant and royalty settlement is based on the residue gas and other products at the tailgate of the plant, the gas consumed as fuel in the plant operations will be considered as being utilized for beneficial purposes*. . . .

Id. at 76600-01 (emphasis added). NTL-4A remains in effect today. 43 C.F.R. § 3164.2(b).

In addition, MMS regulations at 30 C.F.R. § 202.150(b)(1) and (2), pertaining to gas produced from Federal leases, provide:

> (1) All gas (except gas unavoidably lost or *used on, or for the benefit of, the lease*, including that gas used off-lease for the benefit of the lease when such off-lease use is permitted by the MMS or BLM, as appropriate) produced from a Federal lease to which this subpart applies is subject to royalty.
>
> (2) When gas is used on, or for the benefit of, the lease at a production facility handling production from more than one lease with the approval of MMS or BLM, as appropriate, or at a production facility handling unitized or communitized production, only that proportionate share of each lease's production (actual or allocated) necessary to operate the production facility may be used royalty free. [Emphasis added.]

In the preamble to the final rule, in response to a number of comments on the proposed rule, MMS explained the relationship of this provision to NTL-4A and the respective responsibilities of BLM and MMS:

> The determination of whether or not gas has been unavoidably or avoidably lost and whether or not gas used is royalty-free (whether used off-lease or on-lease) are operational matters covered by the appropriate regulations of the Bureau of Land Management (BLM) and MMS for onshore and offshore operations, respectively. The BLM's requirements are governed by the provisions of 43 CFR Part 3160 and Notice of [*sic*] Lessees and Operators No. 4A. The MMS' requirements are governed by the provisions of 30 CFR Part 250 [*i.e.*, the offshore oil and gas lease operations rules]. . . .
>
> Proposed § 202.150(b)(2), which addressed royalty-free use of gas for leases committed to unitization or communitization agreements, has been expanded in the final rules to also cover production facilities handling production from more than one lease with the approval of the appropriate agency. . . . This regulation simply provides that a disproportionate share of the fuel consumed at a production facility serving multiple leases may not be allocated to an individual lease without incurring a royalty obligation on a portion of the fuel.

53 Fed. Reg. 1230, 1233-34 (Jan. 15, 1988). The preamble to the proposed section 202.150(b) stated: "Gas used for the benefit of a lease, which is royalty free, includes gas used in lease equipment on communitized areas or unit areas when the lease is committed to a communitization agreement or unitization agreement . . . ." 52 Fed. Reg. 4732, 4733 (Feb. 13, 1987).

In addition, MMS rules at 30 C.F.R. § 202.151(b), addressing royalty on processed gas produced from Federal leases, provide:

> *A reasonable amount of residue gas shall be allowed royalty free for operation of the processing plant*, but no allowance shall be made for boosting residue gas or other expenses incidental to marketing, except as provided in 30 CFR part 206. In those situations where a processing plant processes gas from more than one lease, only that proportionate share of each lease's residue gas necessary for the operation of the processing plant shall be allowed royalty free. [Emphasis added.]

The preamble to the final rule noted: "Historically, MMS's policy has been to allow a reasonable amount of residue gas to be royalty-free for operation of the processing plant." 53 Fed. Reg. at 1236. The rule continued and codified that practice.

With respect to gas produced from Indian leases, 30 C.F.R. § 202.555 provides in relevant part:

> (a) All gas produced from or allocated to your Indian lease is subject to royalty except the following:
>
> (1) Gas that is unavoidably lost.
>
> (2) Gas that is *used on, or for the benefit of, the lease*.
>
> (3) Gas that is used off-lease for the benefit of the lease when the Bureau of Land Management (BLM) approves such off-lease use.
>
> (4) Gas *used as plant fuel as provided in 30 CFR 206.179(e)*.
>
> (b) You may use royalty-free only that proportionate share of each lease's production (actual or allocated) necessary to operate the production facility when you use gas for one of the following purposes:
>
> (1) On, or for the benefit of, the lease at a production facility handling production from more than one lease with BLM's approval.
>
> (2) *At a production facility handling unitized or communitized production*.
>
> . . . . [Emphasis added.]

Title 30 C.F.R. § 206.179(e) then provides:

> (e) You will be allowed a *reasonable amount of residue gas royalty free for operation of the processing plant*, but no allowance will be made for expenses incidental to marketing, except as provided in 30 CFR part 206. In those situations where a processing plant processes gas from more than one lease, only that proportionate share of your residue gas necessary for the operation of the processing plant will be allowed royalty free. [Emphasis added.]

These provisions have the same substantive import for Indian leases as 30 C.F.R. §§ 202.150(b) and 202.151(b) have for Federal leases. They were promulgated separately on August 10, 1999 (63 Fed. Reg. 43514, effective Jan. 1, 2000), when MMS published substantially revised Indian gas royalty valuation rules.

3. *Processing*

MMS gas royalty valuation rules at 30 C.F.R. § 206.151 define "processing" as

> any process designed to remove elements or compounds (hydrocarbon and nonhydrocarbon) from gas, including absorption, adsorption, or refrigeration. Field processes which normally take place on or near the lease, such as natural pressure reduction, mechanical separation, heating, cooling, dehydration, and compression, are not considered processing. The changing of pressures and/or temperatures in a reservoir is not considered processing.

If a lessee or its affiliate processes gas for extraction of NGLs or other valuable products and sells the residue gas (methane) and the extracted products after processing, the value for royalty purposes of the residue gas and the extracted products is determined under the MMS processed gas valuation rule at 30 C.F.R. § 206.153. In that event, value is "the combined value of the residue gas and all gas plant products determined pursuant to this section . . . less applicable transportation allowances and processing allowances determined pursuant to this subpart." 30 C.F.R. § 206.153(a)(2).

4. *Marketable Condition Requirements*

The valuation regulations for both unprocessed and processed gas at 30 C.F.R. §§ 206.152(i) and 206.153(i), respectively, require lessees to put gas produced from Federal leases into marketable condition at no cost to the lessor (in other words, with no deduction for the cost of treatment in computing royalty). Putting gas into marketable condition may involve, depending on the circumstances, gathering, compression (to the pressure of the relevant transportation pipeline), dehydration, and "sweetening" (removal of gases such as H_2S and CO_2 that form acid compounds when combined with water vapor).[8] Notwithstanding the requirement that the lessee undertake these functions at its own expense, NTL-4A specifically includes gas used

[8] *See*, *e.g.*, *Amoco Production Co. v. Watson*, 410 F.3d 722 (D.C. Cir. 2005); *Amerada Hess Corp. v. Department of the Interior*, 170 F.3d 1032 (10th Cir. 1999); *Mesa Operating Limited Partnership v. Department of the Interior*, 931 F.2d 318, 323 (5th Cir. 1991); *Shoshone & Arapaho Tribes v. Hodel*, 903 F.2d 784 (10th Cir. 1990); *California Co. v. Udall*, 296 F.2d 384, 387-88 (D.C. Cir. 1961); *J-W Operating Co.*, 159 IBLA 1, 11-12 (2003); *Nexen Petroleum U.S.A. Inc.*, 157 IBLA 286 (2002), *affirmed*, *Nexen Petroleum U.S.A. Inc. v. Department of the Interior*, No. 02-3543 (E.D. La. Mar. 31, 2004); *Bailey D. Gothard*, 144 IBLA 17 (1998), *affirmed*, *Bailey D. Gothard v. United States*, No. CV 98-103-BLG (D. Mont. June 29, 1999); *R. E. Yarbrough & Co.*, 122 IBLA 217, 218 (1992).

as fuel in compressors to put gas into marketable condition within the definition of gas used for "beneficial purposes" which therefore is not subject to royalty.

D. *Wexpro's Principal Arguments and BLM's Response*

In its SOR, Wexpro argues that BLM's reliance on the 1990 IM for the proposition that it loses jurisdiction over the gas once it passes through the POM is contrary to the unit agreement. Wexpro asserts that the gas used as fuel in the central facilities on the unit is royalty-free under the terms of the unit agreement, which "does not limit beneficial use to facilities located before the wellhead meters[.]" SOR at 7. Wexpro further asserts that the use of gas anywhere on the unit to run compressors, a dehydrator, and a processing plant is royalty-free under NTL-4A. Additionally, Wexpro argues, BLM is USGS' successor agency in administering NTL-4A and cannot effectively rescind it by saying it has no jurisdiction once gas leaves the wellhead meters. SOR at 8.

Wexpro noted that the SD Decision suggested that Wexpro direct its request for beneficial use to MMS. SD Decision at 3. Wexpro quoted the preamble to MMS' 1988 valuation rule stating that the determination of whether gas used is royalty-free is a BLM operational responsibility. Wexpro noted that it contacted MMS, and MMS responded that it was BLM's responsibility to determine beneficial use of gas. SOR at 9. The result, Wexpro says, is that it "is left in regulatory 'never-never land.'" *Id*.

Wexpro argues that BLM's reliance on *Lone Mountain Production Co.*, 139 IBLA 244 (1997), for its position that it lost jurisdiction to determine beneficial use once the gas passed through the wellhead meters is misplaced because that case involved off-lease use where there was no unit. SOR at 10. In the instant case, Wexpro argues, the unit agreement and NTL-4A compel BLM to treat the gas as royalty-free, and these documents control over any inconsistent provision in the 1990 IM (citing *Burlington Resources Oil & Gas Co.*, 150 IBLA 178, 187 (1999)). *Id*. at 10-11.

In its Answer, BLM relies on the 1990 IM and the *Lone Mountain Production Co.* decision in maintaining that "once gas is downstream of the POM, *even if the gas is still within the lease boundary or the unit*, it is beyond BLM's jurisdiction and responsibility for accounting purposes." Answer at 4 (emphasis added). Therefore, BLM asserts, "gas used for beneficial use past the POM cannot be reported as beneficial use for royalty-free purposes. Any use of gas proposed to be royalty-free past the POM is an MMS matter and should be referred to MMS for consideration as an allowance." *Id*. BLM emphasizes that the wellhead meters are the approved volume measurement points. BLM responds to Wexpro's argument that the unit agreement controls by asserting that "this argument should be made to MMS." SOR at 6. BLM then argues as follows:

> BLM also does not dispute that NTL-4A provides that the use of gas anywhere on the unit is royalty-free, *so long as it qualifies for beneficial use*. However, BLM's jurisdiction to make beneficial use determinations ends at the POM. 43 C.F.R. § 3162.7-3 requires gas measurement to occur on the lease unless off-lease measurement is approved. WO IM 90-474 further clarifies this regulation and states that the opportunity for beneficial use ends at the POM. Thus, regardless of whether the gas is consumed on the unit, once production passes through the POM, BLM simply does not [have] jurisdiction to make beneficial use determinations.

Answer at 7 (emphasis in original). Finally, BLM asserts that "[a]t no point in its April 4, 2007 decision does BLM suggest that Appellant should seek a beneficial use determination from MMS." Answer at 8. What the SD Decision actually states, according to BLM, is that MMS might consider production past the POM, depending on the circumstances, as subject to transportation or other allowances. *Id*.

ANALYSIS

I. *Gas Used as Fuel Within the Unitized Area May Qualify as Used for Beneficial Purposes Even If the Use Occurs After a Wellhead Point of Measurement*.

[1] NTL-4A, as quoted above, provides that "[n]o royalty obligation shall accrue on any produced gas which (1) is *used on the* same lease, same communitized tract, or *same unitized participating area* for beneficial purposes . . . ." 44 Fed. Reg. 76600 (emphasis added). Similarly, under sections 12 and 14 of the unit agreement, gas that is "used in conformity with good operating practices *within the unitized area* for drilling, operating, camp and other production or development purposes" (emphasis added) is not subject to royalty. The regulation at 30 C.F.R. § 202.150(b) provides that gas "used on, or for the benefit of, the lease" is royalty-free, and under paragraph (b)(2) this applies to the lease's share of unitized production. The same principle applies to gas produced from Indian leases under 30 C.F.R. §§ 202.555 and 206.179(e). None of these provisions mandates that such use occur before the POM, or restricts royalty-free treatment to gas that is consumed before the point where production volume is measured, particularly when unit production is measured for royalty purposes only at the respective wellheads.

The compressors, the dehydrator, and the JT facility involved in this case are located within the unitized area, and gas passes through the QGM Comp/JT Plant before it leaves the unit. The fact that gas passes through the POM first is not controlling. The fact that the gas has passed through the POM does not imply that use of part of the gas within the unit for fuel is not for beneficial purposes, or that the only issue with respect to royalty obligations is whether the value of the fuel gas might be deducted as an allowance.

When the gas is consumed as fuel within the unit, BLM cannot effectively amend the unit agreement or NTL-4A or the MMS regulations through an internal instruction memorandum to limit beneficial use only to gas consumed as fuel upstream of the POM, particularly where the POMs are at the respective wellheads. The BLM 1990 IM (assuming, *arguendo*, that it stands for the proposition for which BLM cites it — a question discussed below) cannot control over either the MMS regulations quoted above, the terms of the unit agreement,[9] or the published NTL-4A. BLM's position implies that in any case where a wellhead meter is the approved POM, any use of gas for beneficial purposes must occur *at the wellhead* before gas passes through the wellhead meter.[10] Neither NTL-4A nor the unit agreement nor the MMS regulations supports such a position.

BLM's reliance on the 1990 IM and *Lone Mountain Production Co.* as grounds for disclaiming any role because gas has passed through the POMs is unpersuasive for two reasons. First, the 1990 IM stated that its purpose was "to define that 'point' beyond which BLM's responsibility ceases for the proper accounting of the oil and gas produced from jurisdictional leases." 1990 IM at 1. The sentence on the second page on which BLM relies — "[t]he determination of royalty-free use of production . . . also ceases at this point" [where production is last measured before leaving the lease] — is the only mention of production used on the lease in the entire document, with no further analysis. The 1990 IM's focus is measurement of and accounting for monthly production volume, and determining whether loss of production was avoidable or unavoidable. In that context, BLM's position that its responsibility ends where the production is measured for royalty purposes is perfectly reasonable. But nothing in its position or reasoning implies that BLM is not obligated to evaluate use for beneficial purposes on a lease or unit downstream of that point, before the production leaves the lease or unit, and take that use into account. Even in the context of production measurement and accounting, the 1990 IM does not specifically discuss the possible consequences of unitization or the different points at which unit production may be measured. As to the situation presented in this appeal, the 1990 IM is at best ambiguous.

Second, even though *Lone Mountain Production Co.* involved a number of wells (34 on Federal leases and 6 on state leases), the wells were spread over three different areas and none of the leases was part of a unit. In that case, the compressor was located off the respective leases, after the production not only had been

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[9] *See Burlington Resources Oil & Gas Co.*, 150 IBLA 178, 187 (1999).

[10] This would be the case regardless of whether the lease is part of a unit.

measured, but also had been removed from each of the leases. The lessee was requesting approval for off-lease beneficial use. *See* 139 IBLA at 244. In relying on the 1990 IM, the Board noted that "[a]lthough neither NTL-4A nor Departmental precedent precludes BLM from exercising authority over off-lease beneficial use determinations, those authorities also do not compel BLM to shoulder that responsibility." *Id*. at 249.[11] *Lone Mountain Production Co.* did not involve and did not address the specific language in both NTL-4A and the unit agreement, as well as the 1988 MMS regulation and its preamble, that provides that production used on or within the unitized area is royalty-free. Those provisions are involved here.

We therefore reverse the SD Decision denying Wexpro beneficial use of fuel gas on the ground that it was used in operations after gas had passed through the respective wellhead POMs.

II. *Further Determinations and Factual Development are Necessary Regarding Whether Gas Used as Fuel in the Compressors and the Dehydrator and the JT Facility Is Used for Beneficial Purposes and Whether the JT Facility Is a Processing Plant*.

The present record does not specifically discuss the extent to which the different components of the QGM Comp/JT Plant on the Island Unit (the compressors, the dehydrator, and the JT skid) are for the purpose of putting production into marketable condition or, even if not, whether they are for some other "operating or producing purposes" or "for the benefit of" the leases within the unit. The question becomes whether the gas used in the compressors, the dehydrator, and the JT facility is gas used for "beneficial purposes" (NTL-4A) or "for the benefit of" the leases within the unit (30 C.F.R. §§ 202.150(b) and 202.555(a)(2)) or for "operating, camp and other production or development purposes" (unit agreement).

Additionally, there is the question of whether the JT facility is a "processing plant" within the meaning of 30 C.F.R. §§ 202.151(b) and 206.179(e). That turns on the question of whether or to what extent the functions performed in the JT facility

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[11] The facts in *Lone Mountain Production Co.* allowed the Board to pass over the potential tension between the 1990 IM and the preamble to the 1988 MMS royalty valuation rule with the remark that the preamble "did not purport to prevent BLM from defining the limits of its authority." *Id*. at 249. The Board implied, however, that under the circumstances of that case (where the use was occurring after production had been removed from the lease), MMS could address the request for approval of beneficial use: "We note, however, that our affirmance of BLM's decision should not be construed as a finding that Lone Mountain's beneficial use request should be rejected, but simply as a determination that BLM properly declined approval responsibility for that request." *Id*. at 250.

constitute "processing" under 30 C.F.R. § 206.151 (*i.e.*, whether it uses "absorption, adsorption, or refrigeration" to remove valuable hydrocarbon or nonhydrocarbon compounds from the gas stream). The record in the instant appeal also does not reveal whether gas produced from the Island Unit is valued for royalty purposes as processed gas or as unprocessed gas.

The determination of whether the operation of the JT facility constitutes processing may also make 30 C.F.R. §§ 206.154 and 206.175 (which neither BLM nor Wexpro mentioned) relevant to the outcome on remand. For unprocessed gas, section 206.154(a)(1) provides: "Royalties shall be computed on the basis of the quantity and quality of unprocessed gas *at the point of royalty settlement* approved by BLM or MMS for onshore and OCS leases, respectively." (Emphasis added.) For processed gas, section 206.154(b)(1) provides: "For residue gas and gas plant products, the quantity basis for computing royalties due is the *monthly net output of the plant* even though residue gas and/or gas plant products may be in temporary storage." (Emphasis added.)[12] The processed gas provisions do not specifically mention the approved point of royalty settlement (or perhaps implicitly assume that point to be at the processing plant tailgate). It may be that under the processed gas provisions, gas used as fuel in or upstream of the processing plant is taken into account automatically because it presumably is not part of the net output of the plant (both residue gas and extracted products), which is the volume on which royalty is due. The applicability of these provisions should be addressed on remand, particularly in view of the fact that the BLM-approved point of royalty settlement has remained at the wellhead meters after the QGM Comp/JT Plant was installed on the unit.

We recognize that the determinations needed on remand involve some areas of overlap between BLM-administered provisions and MMS regulations. The two agencies will need to decide between themselves which agency is the appropriate agency to make the various determinations. BLM and MMS are free to arrange their respective responsibilities as they wish. But Wexpro has a right to have the request for approval in its sundry notice addressed. The Department may not effectively leave Wexpro in limbo or nullify its right to royalty-free treatment of gas used for beneficial purposes within the unit by both BLM and MMS disclaiming jurisdiction to act on it.

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[12] Paragraphs (a) and (b), respectively, of section 206.175 are functionally identical provisions for Indian leases.

CONCLUSION

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 C.F.R. § 4.1, the decision appealed from denying Wexpro beneficial use of fuel gas on the ground that it was used in operations after gas had passed through the respective wellhead POMs is reversed and remanded for further action consistent with this decision.

/s/
Geoffrey Heath
Administrative Judge

I concur:

/s/
Lisa Hemmer
Administrative Judge